

ADDENDUM TO REVISED FINAL STATEMENT OF REASONS NON-CONTROLLING SUMMARY

On April 28, 2008, the Board submitted the following regulations for approval: 2558. *Distilled Spirits*, 2559. *Presumption – Distilled Spirits*, 2559.1. *Rebuttable Presumption – Distilled Spirits*, 2559.3. *Internet List* and 2559.5. *Correct Classification*. The Board hereby makes the following changes and/or additions to the Revised Final Statement of Reasons Non-Controlling Summary (4/25/08) (Revised FSR):

1. The following section should be added to the Revised FSR on page 8 before **No Economic Impact** section:

Update

On March 19, 2008, the Board approved for publication revised language to the Regulations and directed that Formal Issue Paper No. 07-007 and its exhibits, be identified as a document relied upon and made available to the public for 15 days. Formal Issue Paper No. 07-007 and its exhibits were made available for 15 days beginning March 21, 2008.

2. The reference to Tab L in 15-day Written Comment 1 on pages 58 and 59 of the Revised FSR is incorrect. The reference should be to Tab N.

3. Add the following to 15-day Written Comment 2. (Page 44, Revised FSR):

- L. Mr. Sorini states that if the Board fails to issue a complete internet list for beer by October 1, 2008, the tax status of potentially thousands of products could be in question, that if the Board can only issue a partial list, some beers would be subject to the beer tax rate and that if the Board does not post a beer list on October 1, 2008, all beers would be subject to the distilled spirits tax rate.

Response

This comment appears to wrongly assume that all beers will be on the Board's Internet List required by Regulation 2559.3. Regulation 2559.3, however, requires that the Board publish and maintain on its Internet site "a listing of all alcoholic beverages that have been found to have successfully rebutted the presumption set forth in Regulation 2559." The Board will develop, publish and maintain such a list. The list, however, does not necessarily include "all beers." Rebutting the presumption set forth in Regulation 2559 is not mandatory.

4. In order to clarify the description of Regulation 2559.1, the following paragraph supersedes the last paragraph of the Response to 15-day Written Comment 1.A. (Page 41, Revised FSR):

The mechanism for rebutting the presumption set forth in Regulation 2559.1 allows the manufacturer to rebut the presumption with respect to any alcoholic beverage by filing a report, under penalty of perjury stating that the alcoholic beverage contains less than 0.5 percent alcohol by volume derived from flavors or other ingredients containing alcohol obtained from the distillation of fermented agricultural products and specifying the sources of the alcohol content of the alcoholic beverage, including the alcohol by volume

derived from flavors or other ingredients containing alcohol obtained by distillation. The ability to rebut the presumption recognizes that many products may contain less than 0.5 percent alcohol by volume from flavors or ingredients containing alcohol obtained from the distillation of fermented agricultural products and that a manufacturer should be allowed to provide the Board with verifying information. Additionally, the report under penalty of perjury mechanism for rebuttal was selected to ensure that only a minimal burden is placed on manufacturers seeking to rebut the presumption. Contrary to CSBA's comments, the ability to rebut the presumption should not result in an undue burden that will require reallocation of a significant portion of the resources of small brewers. As Regulation 2559.1 provides, the manufacturer may submit a report, under penalty of perjury, that specifies the sources and amount of the alcohol content of the beverage. The manufacturer has the choice to decide whether or not to rebut the presumption and the manufacturer has the actual knowledge of the content of the alcoholic beverage. This is a very minimal burden. Accordingly, no changes were made to the Regulations adopted by the Board.

5. Add the following to 15-day Written Comment 1. (Page 40, Revised FSR):

F. Mr. McCormick comments that imposing a "guilty until proven innocent" standard will almost certainly result in small brewers facing significant tax assessments due to inadvertent record keeping errors that have nothing to do with the composition of their beer and is patently unfair to small businesses.

Response

The Regulations do not result in tax assessments because of "inadvertent errors." Whether or not an alcoholic beverage successfully overcomes the presumption set forth in Regulation 2559 is based on a manufacturer's choice to file a rebuttable as set forth in Regulation 2559.1. Any rebuttal is based on whether or not the alcoholic beverage contains less than 0.5 percent alcohol by volume derived from flavors or other ingredients containing alcohol obtained from the distillation of fermented agricultural products, not whether or not there are "inadvertent errors." Additionally, it is not clear what type of "inadvertent errors" Mr. McCormick is referring to. Accordingly, no changes were made to the Regulations as a result of this comment.

6. In order to clarify the Response to 15-day Written Comment 1.E.(2) (Page 43, Revised FSR), the following supersedes the current Response:

Response

See Response to 15-day Comment 1.A. and 1.D.(1), (2) and (4), and Response to 45-day Written Comment 4.B. (as it responds to an annual report comment), above. Additionally, possible "inadvertent" errors, while unfortunate, cannot prevent the Board from exercising its exclusive power to promulgate regulations to clarify the classification of alcoholic beverages for purposes of tax assessment and collection. Accordingly, the Board made no changes to the Regulation as a result of this comment.

7. Item 7 15-day Written Comment 4 begins on page 56 of the Revised FSR. Add the following to 15-day Written Comment 4.E. and Response on page 58 of the Revised FSR:

F. ABC comments that this rulemaking process has the potential to affect alcohol classifications for ABC's purposes impinging on ABC's authority and that ABC's implementing authority for classification and other purposes is found in Business and Professions Code section 25750 giving ABC rulemaking authority "necessary and proper to carry out the purposes and intent of Section 22 of Article XX of the California Constitution. Further, ABC comments that there is no similar broad constitutional authority vested in the Board's implementing authority found in Revenue and Taxation Code section 32451, which does not provide the same authority to implement the Constitutional mandate as part of the Board's rulemaking authority.

Response

Contrary to ABC's comments, the Regulations do not apply or affect alcohol classifications for purposes of the Alcoholic Beverage Control Act. The Regulations are for purposes of clarifying the definition of distilled spirits for purposes of the Alcoholic Beverage Tax Law. Additionally, the Board agrees that Business and Professions Code section 25750 provides ABC regulatory powers for the Alcoholic Beverage Control Act and other powers that ABC possesses as set forth in Article XX, section 22 of the Constitution, however, that regulatory authority does not negate the Board's authority to assess and collect taxes and adopt regulations relating to the administration and enforcement of the Alcoholic Beverage Tax Law (See Response to 45-day Written Comment 2., above.) With the phrase "except as herein provided" in Article XX, section 22 of the Constitution, the Constitution specifically carved out from ABC's authority the Board's authority to assess and collect taxes. (See Cal.Consti., art. XX, § 22.) Accordingly, the Board's authority in Business and Profession Code § 32451 only includes authority for the Board to administer and enforce the Alcoholic Beverage Tax Law. Since, however, ABC has additional authority under the Article XX, section 22 in addition to enforcing the Alcoholic Beverage Control Act; ABC's regulatory authority logically includes regulatory authority for purposes of its duties under Article XX, Section 22 of the Constitution. There is no similar authority for the Board in Business and Profession Code section 32451 because the Board was specifically given in Article XX, section 22 the duty to "assess and collect such excise taxes as are or may be imposed by the Legislature on account of the manufacture, importation and sale of alcoholic beverages in this State." Accordingly, the Board made no changes to the Regulations as a result of this comment.

8. 15-day Written Comment 4. begins on page 56 of the Revised FSR. Add the following after Comment 4.E. on page 58 of the Revised FSR to follow Comment 4.F. which is added by Item 7, above:

G. ABC comments that "[i]t is particularly noteworthy that the historical derivation of § 32451 enacted in 1955 is BPC §25750. Clearly the Legislature intentionally did not include the authority to implement the Constitutional mandate as part of the Board's rulemaking authority."

Response

Contrary to ABC's comments, there is no reason to include "the Constitutional mandate" as part of the Board's rulemaking authority as was provided for ABC since, other than the authority to assess and collect taxes for which regulatory authority is given in § 32451,

there is no other authority given to the Board in Article XX, Section 22 of the Constitution. Whereas, Article XX, Section 22 gives ABC authority other than just to license the manufacture, importation and sale of alcoholic beverages. Accordingly, ABC's regulatory authority includes additional authority for its duties under the Constitution. There was no reason to give the Board "the Constitutional mandate" as additional regulatory authority as it gave to ABC. The Board was given the regulatory authority it requires in order to administer and enforce the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

9. In order to clarify the Response to 15-day Written Comment 2.E.(1) on page 47 of the Revised FSR, the following sentence should be added after the first sentence of the fourth paragraph beginning "As to reason (3)...":

Case No. 506789 is currently stayed pending completion of the rule-making process by order of the court.

10. Add the following reference to the Response to 15-day Written Comment 3.E.(4) (Page 53, Revised FSR):

See Response to 45-day Written Comment 14.L., above.

11. Add the following reference to the Response to 15-day Written Comment 3.L. (Page 56, Revised FSR):

See Response to 45-day Written Comment 14.O. and 14.P., above.

12. Add the following comments to the "Received outside of comment periods" section on page 58 of the Revised FSR:

Comment 2. Mr. Fred Jones on behalf of the Alcopops and Youth Coalition:

Outside of any public comment period, Mr. Jones appeared before the Board at its March 19, 2008, meeting, which included Agenda Item J4 – Chief Counsel Matters RuleMaking, seeking the Board's authorization to submit revised language to the Regulations and Formal Issue Paper 07-007, as a document relied upon, to the 15-day file. Mr. Jones stated his support for the technical amendments proposed to resolve the Office of Administrative Law's technical concerns.

A copy of the Reporter's Transcript are included in the rulemaking record at tab G.

Comment 3. Mr. Gene Livingston, Greenberg, Traurig, on behalf of Miller Brewing and Diageo:

Outside of any public comment period, Mr. Gene Livingston appeared before the Board at its March 19, 2008, meeting, which included Agenda Item J4 – Chief Counsel Matters RuleMaking, seeking the Board's authorization to submit revised language to the Regulations and Formal Issue Paper 07-007, as a document relied upon, to the 15-day file. Mr. Livingston stated that he urged the Board to use the January 1, 2009, effective date suggested by Board staff and pointing out the "new authority" position of the Board with the citation to Section 22 of Article XX of the California Constitution. Mr. Livingston further commented that he would be submitting comments to this addition and

to other additions to the references section of the statutes. Mr. Livingston's written comment received during the public comment period are summarized and responded to in Revised FSR, 15-day Written Comment 3.

13. 15-day Written Comment 3. begins on page 51 of the Revised FSR. Add the following after 15-day Written Comment 3.L. and Response on page 58 of the Revised FSR:

M. Mr. Livingston states that comments submitted by Miller to the initially noticed regulations were submitted to the Board on November 14th, the day before the public hearing held on the Regulations. Further, Mr. Livingston states that those comments were omitted from the rulemaking file when it was first submitted to the Office of Administrative Law (OAL) and no comment was made in the Final Statement of Reasons and once brought to the Board staff's attention an addendum to the Final Statement of Reasons was prepared to "ostensibly" respond to Miller's comments.

Response

Mr. Livingston is correct that he timely submitted, on behalf of Miller, comments during the 45-day public comment period and that those comments were omitted from the rulemaking file when the Regulations were first submitted to the OAL on December 10, 2007. Board staff became aware of the inadvertent omission and subsequently filed an "Addendum To Final Statement Of Reasons Non-Controlling Summary" as part of the rulemaking file on January 16, 2008. Later, in order to make changes recommended by OAL, the rulemaking file was withdrawn on January 24, 2008, and subsequently resubmitted on April 28, 2008. When the file was resubmitted, Miller's comment was included in the Revised FSR. (See Revised FSR, 45-day Written Comments, Comment 14.) Accordingly, any insinuation that Miller's comment has not been properly included in the rulemaking process is unfounded. Accordingly, no changes were made to the Regulations based on this comment.

14. 45-day Written Comment 14. begins on page 30 of the Revised FSR. Add the following after 45-day Written Comment 14.P. and Response on page 35 of the Revised FSR:

Q. Mr. Livingston comments that the Board cannot implement, interpret or make specific Business and Professions Code sections 23005 and 23006, and that Revenue and Taxation Code sections 32002, 32452 and 32453 are not proper reference citations.

Response

Revenue and Taxation Code section 32451 provides the Board general regulatory authority to promulgate regulations for the Alcoholic Beverage Tax Law. The Board is utilizing this authority in order to clarify, under the Alcoholic Beverage Tax Law, the definition of "distilled spirits," which definition (Bus. & Prof. Code, § 23005) is specifically incorporated by reference into Part 14, the Alcoholic Beverage Tax Law, by Revenue and Taxation Code section 32002. Business and Professions Code section 23005 is, therefore, set forth in Part 14, the Alcoholic Beverage Tax Law, and the Board has general authority to promulgate regulations pursuant thereto. (Rev. & Tax. Code, § 32451.) Revenue and Taxation Code sections 32002, 32452 and 32453 are set forth because those are the statutes that are being implemented, interpreted or made specific by these Regulations and also assist the reader in finding relevant code sections applicable to

the Regulations. For example, Regulation 2559.1 allows a manufacturer to file a “report” and Revenue and Taxation Code section 32452 allows the Board to request “reports” and Revenue and Taxation Code section 32453 addresses the Board’s authority to examine the books and records of individuals or entities who sell, manufacture, warehouse, or transport alcoholic beverages. Further, Revenue and Taxation Code section 32002 sets forth the incorporation of the definitions found in the Alcoholic Beverage Control Act. Accordingly, the Board made no changes to the Regulations as a result of this comment.

R. Mr. Livingston comments that the Board is obligated to follow the Alcoholic Beverage Control Board (ABC) as evidenced by Section 23355 of the Business and Professions Code which provides that the licenses issued to a person authorize the person to whom issued to exercise the rights and privileges specified in this Article and no others. For example, the comment provides that a license issued to a person to produce beer does not entitle that person to produce distilled spirits.

Response

The Board does not disagree that the rights conferred by the licenses issued by ABC are issued to the person to exercise the rights and privileges specified in the Alcoholic Beverage Control Act. Contrary to Mr. Livingston’s comment, the proposed regulatory action does not apply to or infringe in any manner on the ABC’s “exclusive power, except as herein provided and in accordance with the laws enacted by the Legislature, to *license* the manufacture, importation and sale of alcoholic beverages in this State.” (Cal.Consti., art. XX, 22 (emphasis added).) The Regulations are for purposes of assessing and collection of taxes imposed by the Legislature under the Alcoholic Beverage Tax Law. Accordingly, the Board made no changes to the Regulations as a result of this comment.

S. Mr. Livingston comments that Revenue and Taxation Code section 32101 providing for the registration under the Revenue and Taxation Code also requires the Board to follow the Alcoholic Beverage Control Board (ABC).

Response

The Board disagrees with this comment. Section 32101 does not provide that the Board is to tax in accordance with the license issued by ABC. Section 32101 provides that the issuance of a license by ABC “shall constitute *registration* of the person to whom the license or permit is issued as a taxpayer...” (Emphasis added.) The plain language is “shall constitute registration.” The Regulations do not impact this section. The Board will continue to register the person as licensed by the ABC. The Regulations do not impact ABC’s authority to license the manufacture, importation and sale of alcoholic beverages in this State. The Regulations are for tax purposes only. Accordingly, the Board made no changes to the Regulations as a result of this comment.

T. Mr. Livingston comments that Business and Professions Code sections 23364, 23368, 23374.6, 23384, and 24049, which center on rights and limits on licenses further demonstrates that the Legislature intended for excise taxes to be assessed and collected consistently with the license.

Response

Contrary to Mr. Livingston's comment, none of these sections provide that excise taxes must be assessed and collected consistently with the license issued by ABC. The sections cited in the comment merely provide what a licensee can do with the license issued to them. There is no ambiguity in the language that would lend itself to any interpretation. Further, the Regulations do not impact ABC's authority to license the manufacturer, importation, and sale of alcoholic beverages in this State. The Regulations are for purposes of the Alcoholic Beverage Tax Law only. Accordingly, the Board made no changes to the Regulations as a result of this comment.

U. Mr. Livingston comments that the Legislature demonstrated its intent for excise taxes to be assessed and collected consistently with the license by enacting Revenue and Taxation Code section 32202.

Response

The Board disagrees with the comment. The statute merely provides for tax by common carriers, or by other persons licensed to sell distilled spirits. There is no ambiguity in the language that would lend itself to any interpretation. Further, the Regulations do not impact ABC's authority to license the manufacturer, importation, and sale of alcoholic beverages in this State. The Regulations are for purposes of the Alcoholic Beverage Tax Law only. Accordingly, the Board made no changes to the Regulations as a result of this comment.

V. Mr. Livingston comments that Revenue and Taxation Code section 32101 was amended in 2005 and that if the Legislature disagreed with the classification by the ABC on flavored malt beverages at the beer rate, it would have had an opportunity to address it. But since it did not, that demonstrates that the 50-year practice of the ABC classifying alcoholic beverages for both licensing and taxing purposes was consistent with the Legislatures intent.

Response

The Board disagrees with the comment. First, why the Legislature would change 32101 to reflect any perceived misclassification of an alcoholic beverage is not clear in the comment. Revenue and Taxation Code section 32101 merely provides that the Board will register taxpayers as they are licensed by ABC. There is no ambiguity in the language that would lend itself to any interpretation. Further, the changes to section 32101 referenced in the comment merely added "or wine direct shipper permit" and made other nonsubstantive changes. Any clarification of classification would be misplaced in section 32101. The Constitution is clear that the Board retained the authority to assess and collect excise taxes on the manufacture, importation and sale of alcoholic beverages in this State. (Cal.Consti., art. XX, 22.) The Regulations are for purposes of the Alcoholic Beverage Tax Law only. The Regulations do not impact ABC's authority to license the manufacturer, importation, and sale of alcoholic beverages in this State. Accordingly, the Board made no changes to the Regulations as a result of this comment.

15. In the **Specific Purpose/Necessity** section, the following paragraph supersedes the first paragraph under **Regulation 2559.1** (Page 5, Revised FSR):

This regulation allows the manufacturer of an alcoholic beverage to rebut the presumption set forth in Regulation 2559 as to any particular alcoholic beverage by filing

a report, under penalty of perjury, that specifies that the alcoholic beverage contains less than 0.5 percent alcohol by volume derived from flavors or other ingredients containing alcohol obtained from the distillation of fermented agricultural products and specifying the sources of the alcohol content of the alcoholic beverage, including the alcohol by volume derived from flavors or other ingredients containing alcohol obtained by distillation. This regulation also provides that the Board shall require a copy of a manufacturer's "Statement of Process" or product "Formula" filed with the Alcohol and Tobacco Tax and Trade Bureau, its predecessor agency or successor agency, only if the Board obtains information that casts doubt on the accuracy or truthfulness or a report filed or for the purposes of verifying any report filed. Such a rebuttal and verification process is necessary to ensure that the correct amount of tax is being paid and collected.

16. In the **Specific Purpose/Necessity** section, the following paragraph supersedes the third paragraph under **Regulation 2559.3** (Page 6, Revised FSR):

The "[n]ot later than October 1, 2008" language in the regulation is necessary to provide interested parties affected by the regulation, and the Board, sufficient time to facilitate an efficient implementation of the new regulation.

17. In order to clarify the Response to 45-day Written Comment 4.F. (Page 22, Revised FSR), the following supersedes the current Response:

Response

See Response to 45-day Written Comment 14., and Response to 15-day Written Comment 2.D., below. The Board is mandated to administer the Alcoholic Beverage Tax Law. Revenue and Taxation Code section 32002 incorporates by reference the definitions set forth in the Alcoholic Beverage Control Act. Those definitions are now part of the Alcoholic Beverage Tax Law, the law the Board is required to administer. The Board has determined that the definition of "distilled spirits" requires clarity with respect to FMB. Based on general regulatory authority granted to the Board in Revenue and Taxation Code section 32451, the Board has the authority to adopt regulations relating to the administration of the Alcoholic Beverage Tax Law (i.e., Part 14, Division 2, of the Revenue and Taxation Code). The adopted Regulations are not for purposes of the Alcoholic Beverage Control Act. Accordingly, the Board made no changes to the Regulations as a result of this comment.

18. In order to clarify the Response to 15-day Written Comment 2.D. (Page 46, Revised FSR), the following supersedes the first and second paragraph of the Response:

See Response to Written Comments 3.C. and 7., above. The Board is not creating its own alcoholic beverage classification. The Board is clarifying, under the definition of "distilled spirits" in the Alcoholic Beverage Tax Law, what alcoholic beverages fall under the classification of "distilled spirits." The Board does not disagree that Revenue and Taxation Code section 32002 incorporates by reference the definitions set forth in the Alcoholic Beverage Control Act. Those definitions are now part of the Alcoholic Beverage Tax Law, the law the Board is required to administer. Accordingly, pursuant to its authority to promulgate regulations under the Alcoholic Beverage Tax Law (Rev. & Tax. Code, § 32451), the Board has adopted the Regulations in order to clarify for

purposes of taxation when an alcoholic beverage meets the definition of a “distilled spirit” or a “beer.”